

April 24, 2008

Michael A. Macchiaroli, Esq.  
Associate Director  
Securities and Exchange Commission  
Division of Trading and Markets  
100 F Street, NE  
Washington, DC 20549

Dear Mr. Macchiaroli,

This letter is a follow-up to our April 11, 2008 letter to you, which provided temporary relief from the requirements of SEC Rules regarding the net capital charges applicable to credit extended on Auction Rate Preferred Securities (ARPS) under certain circumstances. Pursuant to FINRA *Regulatory Notice 08-08* ([www.finra.org/Notices/08-08](http://www.finra.org/Notices/08-08)) (the *Notice*), which increases the margin requirements on Auction Rate Securities (ARS) in response to concerns about the reduced liquidity in the market resulting from failed auctions in such securities, FINRA member firms were reminded that ARPS are not margin-eligible under Regulation T and, as such, 100 percent maintenance margin is required on such securities. The *Notice* also reminded member firms that NYSE Rule 431(e)(7)(C), NASD Rule 2520(e)(7)(C) and SEC Rules 15c3-1(c)(2)(iv)(B) and 15c3-1(c)(2)(xii), require that the amount of any deficiency between the equity in the account and the margin required shall be deducted in computing the net capital of the member firm.

The Securities Industry Financial Markets Association and representatives of broker-dealers expressed a need to be able to provide liquidity to customers holding ARPS, as outlined in the April 11 letter, and in order to do so, requested regulatory relief from the margin requirements and the net capital charges required by SEC Rule 15c3-1 with respect to the non-purpose credit extended to customers collateralized by ARPS. In support of this request, the industry representatives stated, among other things, that the underlying credit quality of most ARS issuers has not been affected, the securities are highly rated and banks are willing to extend collateralized loans to broker-dealers and to receive ARPS as collateral for such loans.

The April 11 letter states that, based on our discussions with you, we understand that SEC staff agreed that member firms would not be required to apply a charge to their net capital for any margin deficiencies resulting from non-purpose credit extended on ARPS, nor to exclude from the customer reserve formula computation, such non-purpose loans to customers, provided that firms met the conditions specified in such letter. Among other conditions, to qualify for relief from the aforementioned net capital charges, member firms would be required to limit the amount of the non-purpose credit extended to no more than 25 percent of their excess net capital and to obtain a bank loan(s), with a remaining maturity of no less than six months at the time that such credit is extended, for the aggregate amount of non-purpose credit extended to customers secured by ARPS.

Recently, it has become more difficult for some FINRA member firms to secure bank loans collateralized by ARPS, rendering unavailable the relief granted through the April 11 letter when

extending non-purpose credit on ARPS to their customers. Furthermore, the need to provide liquidity to customers holding ARPS is on-going.

Based on this updated information and subsequent discussions with you, it is our understanding that SEC staff is in agreement that FINRA member firms who are not able to obtain bank loans for the amount of credit extended to customers collateralized by ARPS may be permitted to extend such credit to customers, up to an amount equal to 25 percent of their excess net capital, without having to apply a net capital charge for the credit extended, even though the member firms have not obtained a bank loan(s) for the aggregate amount of such credit extended. Member firms must notify their FINRA Coordinator prior to extending such credit and will be subject to the following requirements and conditions:

1. The ARPS pledged as collateral by the customer to the broker-dealer for the non-purpose loan must be rated in the highest rating category by an NRSRO and must not be subject to credit review by an NRSRO at the time that such credit is extended;
2. The aggregate amount of credit to be extended on such non-purpose loans to customers must not exceed 25 percent of the broker-dealer's excess net capital, computed as of the most recent month end and adjusted for any subsequent material decrease at the time that such credit is extended;
3. The non-purpose credit extended to any single customer must not exceed 50 percent of the value of the ARPS pledged by the customer as collateral to such loan;
4. The aggregate of all such non-purpose loans shall be considered as a scheduled capital withdrawal under NYSE Rule 326 and NASD Rule 3130, unless otherwise deducted in the computation of net capital;
5. A broker-dealer must report on a monthly basis to FINRA the aggregate dollar amount of credit extended to customers through non-purpose loans collateralized by ARPS.

FINRA member firms that are able to obtain a bank loan(s) in accordance with condition #4 of the April 11 letter may extend credit in an amount equal to an additional 25 percent of their excess net capital, as long as such credit is extended pursuant to the requirements of the April 11 letter. However, in no circumstances shall the aggregate of all non-purpose credit extended to customers collateralized by ARPS exceed 50 percent of the member firm's excess net capital computed as of the most recent month end and adjusted for any subsequent material decrease at the time that such credit is extended.

***Note: Non-purpose credit extended to customers in accordance with conditions 1 – 5 specified in this letter may not be included as a debit item in the member firm's customer reserve formula computation.***

We understand that this relief will be temporary and will be reviewed in consultation with your office for amendment or reconsideration, if and as circumstances may warrant.

Very truly yours,



Krisoula Dailey  
Vice President